IN THE

Supreme Court of the United States

October Term, 1942.

No. 452.

CORN EXCHANGE NATIONAL BANK AND TRUST COMPANY, PHILADELPHIA, and EDWARD C. DEARDEN, SR.,

Petitioners,

v.

NORMAN KLAUDER, Trustee of the Estate of QUAKER CITY SHEET METAL CO., Bankrupt,

Respondent.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

BRIEF FOR RESPONDENT.

BERTRAM BENNETT,
HARRY L. JENKINS
RAWDON LIBBY,
12 South 12th Street,
Philadelphia, Pa.,
Counsel for Respondent.

International, 236 Chestnut St., Philadelphia

INDEX TO BRIEF FOR RESPONDENT.

TABLE OF CASES CITED.

AUTHORITIES AND REPORT CITED.

STATUTES CITED.

IN THE

Supreme Court of the United States.

No. 452. October Term, 1942.

CORN EXCHANGE NATIONAL BANK AND TRUST COMPANY, PHILADELPHIA, AND EDWARD C. DEARDEN, SR.,

Petitioners,

v.

NORMAN KLAUDER, TRUSTEE OF THE ESTATE OF QUAKER CITY SHEET METAL CO., BANKRUPT,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

Brief for Respondent.

Argument.

THE APPLICABLE PENNSYLVANIA RULE.

It is to be observed that by the decision of this Court in *Erie Railroad Company v. Tompkins*, 304 U. S. 64, the unwritten or common law of the state, as declared by its highest court, in the absence of any conflict with the Constitution of the United States or the federal statutes, is binding upon the federal courts whose duty it is to follow it. That decision expressly overruled cases to the contrary, more particularly, *Salem Trust Company v. Manufac-*

turers Finance Company, 264 U. S. 182, and decisions which preceded it.

We have heretofore maintained and the Circuit Court of Appeals has found (Record 44, 45, 46) that the decision of the Supreme Court of Pennsylvania in *Phillips's Estate* (No. 3) 205 Pa. 515, decided in 1903, is controlling. It is therein held that if an assignee of a chose in action fails to give notice to the person holding the fund assigned to him, a subsequent assignee, without notice of the former assignment, will, upon giving notice of his assignment, acquire priority.

In the Circuit Court of Appeals, it was contended by our opponents, as they argue here, that the import of this decision was neutralized by another decision in the same estate rendered by the Supreme Court of Pennsylvania on the same day in *Phillips's Estate*, (No. 4) 205 Pa. 525, in which priority was awarded to an assignee who had not given notice over a subsequent assignee who had given notice. A claimant to a share in a decedent's estate had transferred his interest to successive assignees. The first did not give notice and the second did. In the period intervening between the two assignments a creditor of the claimant attached the fund. The court awarded the creditor priority over the second assignee because the attachment was served prior to the date of the second assignment. The lien of the creditor, however, was subordinated to that of the first assignee. It was held that as between the assignor and the assignee, the assignment was valid with or without notice; that by the attachment, the creditor became an equitable assignee of that which his debtor still had a right to assign, and that as to the creditor, the prior assignment, with or without notice, was valid.

The Circuit Court of Appeals concluded (Record 45) and we submit properly so, that the decision in *Phillips's Estate* (No. 4) involved the determination of the rights of an attaching creditor; that it was based on the theory that an attaching creditor could not secure rights superior to those of a prior assignee even though the latter had not given notice and accordingly held that the decision did not in any way modify the ruling in *Phillips's Estate* (No. 3) with regard to the priority between successive assignees where the first assignee has failed to give notice.

Judge Maris, speaking for the Circuit Court of Appeals, aptly points out, in the majority opinion, that we are here concerned with the rights of purchasers as well as creditors, wherein he states (Record 45):

> "The rule as to the time of making a transfer, which is laid down in the second sentence of Section 60a, cannot operate to fix that time as of the time of actual transfer unless two bases for such operation are present. It must appear to have then been so far perfected that (1) no bonafide purchaser and (2) no creditor could thereafter have acquired superior rights in the property transferred. In the case before us it is immaterial that Phillips's Estate (No. 4), which deals with the rights of creditors, provides one of the bases for the operation of the rule in favor of the date of actual transfer since Phillips's Estate (No. 3), which fixes the rights of purchasers does not provide the other basis. As we have said, the statute requires the presence of both. Consequently if, as here, one is absent, the date of transfer must be deemed to be postponed to the later date fixed by the second sentence of subdivision a, in this case the date of bankruptcy."

STATUTORY DEVELOPMENT OF PREFERENCE DOCTRINE.

A proper approach to the question and a determination of the purpose of the revision of Section 60 of the Bankruptcy Act requires an examination of the history of the legislation. The section has been the subject of several amendments, the purpose of all of which has been to strike down secret transfers executed but not disclosed by recording or change of possession until immediately prior to the bankruptcy of the transferor.

Under the Bankruptcy Act of July 1, 1898, c. 541, Section 60, 30 Stat. 562, 11 U. S. C. A., Sec. 96, Section 60b provided merely that any preference given within four months before bankruptcy might be voidable by the trustee. The section made no provision for cases where recording of a transfer, by state laws, was involved.

The Amendment of February 5, 1903, c. 487, Section 13, 32 Stat. 799, 11 U. S. C. A., Sec. 96 added a provision to Section 60a that "where the preference consists in a transfer, such period of four months shall not expire until four months after the date of recording or registering of the transfer, if by law such recording or registering is required". Following that amendment it was held, however, that the time of recording as distinguished from the date of transfer was not necessarily the test as to its preferential character.

> *Collier on Bankruptcy*, 14th Ed., Vol. 3, page 870.

On June 25, 1910, c. 412 Sec. 11, 36 Stat. 842, 11 U. S. C. A. Sec. 96, the section was further amended so as to provide that the transfer should be voidable "If by law recording or registering thereof is required, and being

within four months before the filing of the petition in bankruptcy—the bankrupt be insolvent and the transfer then operate as a preference" etc. It was thereafter held that a transfer was required to be recorded where, under state law, recording was essential in order to make the transfer valid as against creditors including those whose position the trustee was entitled to take. On the other hand, a transfer was not required to be recorded where, by state law, an unrecorded transfer was void only as against subsequent purchasers for value.

Collier on Bankruptcy, supra, page 870.

At that stage of the law, before a trustee in bankruptcy could avoid a transfer, this Court held that he had to represent in fact or be entitled to take the status of a creditor whose claim actually stood in a superior position to the challenged transfer, while unrecorded and within the specified period. Although there was evidence of legislative intent to determine the preferential nature of a transfer as of the date of recording and the same was given effect by some federal courts, the decisions of this Court in *Bailey v. Baker Ice Machine Co.*, 239 U. S. 268, 35 Amer. B. R. 814, 36 S. Ct. 50, 60 L. Ed. 275, *Carey v. Donohue*, 240 U. S. 430, 36 Amer. B. R. 704, 36 S. Ct. 386, 60 L. Ed. 726 and *Martin v. Commercial National Bank*, 245 U. S. 513, 40 Amer. B. R. 765, 38 S. Ct. 176, 62 L. Ed. 441, settled the controversy. Thus it became established by this Court (1) that a transfer was not required to be recorded or registered where, under applicable state law, an unrecorded transfer was defeasible only as against subsequent purchasers in good faith, (2) that a transfer was required to be recorded where failure to record made the transfer voidable by general creditors, and (3) where recording was required, the preferential

character of the transfer was to be determined as of the date of recording, but if recording was not required determination had to be made as of the date of the transfer itself, not as of the date of recording, nor as of the taking of actual possession under a prior unrecorded transfer. Moreover, before a trustee could successfully avoid a transaction not required to be recorded, but which in fact was recorded or possession taken by the creditor some time prior to bankruptcy, it was necessary that the trustee in fact represent or be entitled to take the place of some creditor whose claim actually stood in a superior position to the challenged transfer. Accordingly, as in the *Martin* case, *supra*, where the state law made an unrecorded conveyance defeasible only as to creditors who, prior to recording, had acquired a lien by attachment or execution and there was actually no such creditor prior to recording, the trustee was not in a position to challenge the transfer, except possibly as a fraudulent conveyance.

Collier on Bankruptcy, supra, pages 873, 874.

By the Act of May 27, 1926, c. 406, Sec. 14, 44 Stat. 666, 11 U. S. C. A. 96, the section was again amended to overcome the effect of unfavorable judicial interpretation by adding the words "or permitted" to the last sentence of Section 60a. It was thereafter held nevertheless that Congress had not effectively changed the definition of a preferential transfer although there were decsions to the contrary.

Collier on Bankruptcy, supra, ~~page 874~~.

The history of the efforts of Congress from 1903 to 1926 to strike down secret liens by the amendments to Section 60, and the interpretations of the courts thereon are summarized by Judge Lindley of the United States District Court for the Eastern District of Illinois in the matter of

Hirschfeld, Trustee v. Nogle, 5 Fed. Supp. 234, 24 Amer. B. R. (New Series) 363.

Thus the law stood until the amendment of June 22, 1938, c. 575, 52 Stat. 869, 11 U. S. C. A. Sec. 96.

THE CONGRESSIONAL INTENT.

In tracing the history of the changes in Section 60 of the Bankruptcy Act of 1898, we have endeavored to demonstrate a continuing and fairly evident legislative intent to strike down secret transfers by establishing a test as to perfection that fixes the date of notoriety as the time when its preferential character should be determined. It has been said that this intent has been manifest and clear, but that its expression was faulty as a result of which achievements have been weak. Turning to the Amendment of 1938, it is apparent that the draftsmen endeavored to clarify the entire section and to restate it so that a comprehensive test would be afforded for the purpose of reaching all types of secret liens and transfers.

The House Committee in which the amendment was formulated thus states its reasons for rewriting this section. (Report No. 1409 on H. R. 8046, July 29, 1937, 75th Congress, 1st Session):

> "Present Sec. 60a: The language of the present law is cumbersome, and the definition of a preference is not a scientific one. If literally construed, the percentage test may be restricted to the situation existing at the time the transfer is made. Some courts have, in fact, adopted such literal construction. However, the preferential nature of the transfer should be tested rather by the ultimate result, which is the view taken by other courts. The conflict has recently been settled by the Supreme Court in the case of Palmer Clay Products Co. v. Brown (56 S. Ct. 450, 80 L. Ed. 655) in

favor of the retrospective construction. It is thereby deemed advisable to eliminate the overlapping, discard the present cumbersome phrasing, and state the test more accurately, scientifically and comprehensively. Section 60 a as recast accomplishes this desirable result. The new test is more comprehensive and accords with the contemplated purpose of striking down secret liens. It is provided that the transfer shall be deemed to have been made when it became so far perfected that neither a bona fide purchaser nor creditor could thereafter have acquired rights superior to those of the transferee. As thus drafted, it includes a failure to record and any other ground which could be asserted by a bona fide purchaser, or a creditor of the transferor, as against the transferee. A provision also has been added which makes the test effective even though the transfer may never have actually become perfected."

From this language it is certainly logical to assume that it was not the intention of Congress to limit transactions affected to those subject to recording statutes for this was already established by existing law. On the contrary, it is respectfully submitted that the phraseology above quoted in the House Committee Report, evidences a clear intention to extend the scope and application of the section to reach so-called equitable liens which may require perfection or steps essential to a valid transfer at common law.

Doubt has been expressed whether the draftsmen of the act contemplated the result which has been reached in the instant case. Professor James Angell McLaughlin of Harvard University Law School, a member of the National Bankruptcy Conference, which was largely responsible for the drafting of the act, and who is credited with the

phraseology employed in the section under consideration, in his article, "*Aspects of the Chandler Bill to Amend the Bankruptcy Act,*" 40 University of Chicago Law Review 369 (April 1937), at page 393, said:

> "How great a step to take with particular reference to the status of the trustee has been the subject of repeated and extensive debate in the Conference. (National Bankruptcy Conference.)* The Chandler Bill has not embraced the solution perhaps most obviously suggested by the Martin Case (Martin v. Commercial National Bank, 245 U. S. 513)* to give the trustee the status of the holder of a lien antedating bankruptcy by four months. That would give him an undesirable seniority over bona fide transferees. The solution proposed is a simple declaration that for the purpose of avoiding preferences, a 'transfer shall be deemed to have been made at the time when it became so far perfected that no bona fide purchaser from the debtor and no creditor could thereafter have acquired any rights in the property so transferred superior to the rights of the transferee.' It will be observed that by giving the trustee the status of a bona fide purchaser he is brought within the protection of the common real estate recording acts, thus reversing not only the Martin case and like cases but the leading case of Carey v. Donohoe (240 U. S. 430),* which arose on a Georgia real estate statute. Furthermore the phrasing is not limited to secret liens within the recording acts. It is broad enough to cover analogous cases such as those where a judge-made 'equitable lien' is invoked to save secret transfers invalid for failure to take the steps essential to a valid transfer at common law."

It would appear that Professor McLaughlin's article was brought to the attention of the Congressional Commit-

---

*Inserts ours.

tees when the Bill was under consideration and that there is no doubt as to the intention of the Conference when the Bill was prepared. Professor McLaughlin states further (at page 394):

> "The Bill further has the strength and weakness of a single crisp revision covering a multitude of situations. The 1927 precursor of this paragraph contained, for instance, a separate paragraph upon the topic of floating liens. This paragraph, along with various other attempts to spell out particular situations, was eliminated in the Conference, pursuant to the general theory that the statement of one detail invites another and that bankruptcy laws should not undertake detailed codification concerning business transactions."

Thus it is demonstrated that the purpose of the draftsmen was to develop a test of perfection of transfer that would apply to real and chattel mortgages, conditional sales, trust receipts, equitable liens, assignments and any other type or modes of transfer whereby a creditor obtains security for the obligation owned. It is equally clear that the very essence of the change made in the section is the establishment of the time when the preferential character of the transfer is to be judged. While it is true that the construction reached by the Circuit Court of Appeals here results in the shifting of the time of transfer from the date when the transaction was originally entered into, closer to the date of bankruptcy, this is the very objective of the provision, namely, the striking down of the advantage sought to be gained by secrecy.

It is also to be observed that the amendment simultaneously made to Section 67b of the Bankruptcy Act (Act of June 27, 1938, c. 575, Sec. 1, 52 Stat. 875, 11 U. S. C. A. Sec. 107), is also indicative that Congress had in mind that the

amendment to Section 60 would have the effect which the Circuit Court of Appeals has ascribed to it? Section 67b as so amended, provides:

> "The provisions of section 60 of this Act to the contrary notwithstanding, statutory liens in favor of employees, contractors, mechanics, landlords, or other classes of persons, and statutory liens for taxes and debts owing to the United States or any State or subdivision thereof, created or recognized by the laws of the United States or of any State, may be valid against the trustee, even though arising or perfected while the debtor is insolvent and within four months prior to the filing of the petition in bankruptcy or of the original petition under Chapter X, XI, XII or XIII of this Act by or against him. Where by such laws such liens are required to be perfected and arise but are not perfected before bankruptcy, they may nevertheless be valid, if perfected within the time permitted by and in accordance with the requirements of such laws, except that if such laws require the liens to be perfected by the seizure of property, they shall instead be perfected by filing notice thereof with the court."

This strongly implies that Congress understood that Section 60, as amended, might otherwise have invalidated such liens. Under the law as it stood prior to 1938 and our opponents' contention as to the meaning of Section 60, as now amended, that would seldom, if ever, be true. For illustration, the law prior to the 1938 amendment did not prevent a landlord from securing payment of his rent in full by suing out and levying a distress warrant immediately before bankruptcy—*Henderson v. Mayer*, 225 U. S. 631, 56 L. Ed. 1233. This was so because the distress warrant was held not to create a lien, but merely to perfect an inchoate lien which had previously arisen by operation of the law. If the Petitioners' contention as to the meaning

of Section 60, as amended, be correct and the question as to whether a lien secures an antecedent debt is to be determined as of time when the lien came into existence, rather than as of the time when it was so far perfected as to be good as against bona fide purchasers, Section 60, as amended, will still have little, if any, effect on such liens since practically, they always arise by operation of law simultaneously with the creation of the debt. On the other hand if Section 60 is given the interpretation made by the Circuit Court of Appeals in the instant case, it would invalidate many such liens in the absence of an amendment of Section 67b, so that there was need to amend 67b to except them from its operation.

DISCUSSION OF DECISIONS.

In *Adams v. City Bank and Trust Co.*, 115 Fed. (2d) 453, 44 Amer. B. R. (new series) 196; cited by Petitioners (their brief page 18) the Circuit Court of Appeals for the Fifth Circuit, in construing the amendment, held that the contention which we make here, fails to give due weight to the first sentence of Section 60a, which provides that a preference is a transfer of the property of a debtor "for or on account of an antecedent debt." Thus, that court held that irrespective of the absence of notice, there could not be an antecedent debt if the assignments were made at the time the moneys were loaned and hence the section had no application whatsoever to the situation with which we are here concerned. In other words, it is the ruling of that court that the words "antecedent debt" are the guide by which the language of the entire section must be construed and restricted.

We submit that this decision is contrary to the plain and express language of the statute. Following the defini-

tion of a preference Section 60a recites that "For the purpose of subdivisions a and b of this section, a transfer shall be deemed to have been made etc." This provision does not merely relate to the words "transfer" and "made" appearing in the definition, but on the contrary, is intended to and does qualify the entire definition of a preference including the words "for and on account of an antecedent debt" found in subdivision a. If the monies were advanced and the debt thus created and the transfer or assignment of the accounts, is by the terms of the act, held to have been made at the time of perfection, then, it must necessarily follow that what might have been or intended to be a present consideration, becomes an antecedent debt within the meaning of the statute.

As the Petitioners' brief states (page 19) the same court in *Girand v. Kimbell Milling Co.*, 116 Fed. (2d) 999, followed its earlier decision in the *Adams* case, *supra*.

We submit that the conclusion reached by the Fifth Circuit is wholly predicated upon decisions of this Court prior to the adoption of the 1938 amendment, especially *Carey v. Donohue* and *Martin v. Commercial National Bank*, *supra*, and is wholly at variance with the manifest object and purpose of the legislation. If this construction be adopted by this Court, no change, however intended or manifested, will have been made in the section. The result will continue to be that where recording is necessary, it can be withheld until a few days prior to bankruptcy, secrecy thus maintained as to the creditors and the transferee will prevail. This is one of the very situations which the amendment was designed to cure and we submit that the language employed is sufficiently clear to warrant the construction reached by the Circuit Court of Appeals in the instant case.

In the matter of Talbot Canning Corporation, 35 Fed. Supp. 680, 44 Amer. B. R. (New Series) 811 (Petitioners' brief page 20), the District Court of the United States for the District of Maryland likewise reached the conclusion that transfers for a present consideration are not, by the language of the amendment, brought within the purview of voidable preferences; taking the position that if value be given, there can be no depletion of the bankrupt's estate and hence no preference; that the definition of a preferential transfer in Section 60 is confined to a transfer given "for or on account of an antecedent debt". We think that this conclusion is similarly erroneous for the reasons heretofore assigned. We respectfully submit that the conclusion of Judge Maris in the instant case is in keeping with the object, purpose and spirit of the amendment where in the majority opinion he said (Record 43):

> "It will be noted that the subdivision comprises two sentences. The first lays down the criteria for determining whether a transfer is preferential. The second sentence provides that for the purposes of subdivision a, inter alia, a transfer shall not be deemed to have been made until it has been perfected as against bona fide purchasers from and creditors of the debtor.
>
> It will be seen that one of the criteria laid down by the first sentence of subdivision a for determining whether a transfer is to be treated as a preference is that it is 'for or on account of an antecedent debt.' The question with which we are primarily concerned in this case involves the meaning of this phrase. The question is this. In determining whether a debt is antecedent to a transfer made on account of it are we to apply the rule laid down in the second sentence as to when a transfer is to be deemed as having been made? In other words, is a debt to be treated as ante-

cedent to a transfer actually made contemporaneously but not perfected as against purchasers and creditors of the debtor until a later time? We think that a fair construction of the statutory language requires an affirmative answer to this question. The rule which the second sentence of subdivision a lays down as to the time when a transfer is to be deemed to have been made is stated, to be 'for the purposes of subdivision a,' inter alia. It is thus clear that the rule is intended to apply to the provisions of the first sentence of that subdivision insofar as they involved questions having to do with the time of making a transfer. There is no indication that its application to the first sentence is to be restricted to the mere determination of whether a transfer is made while the debtor is insolvent and within four months of bankruptcy. On the contrary it is obvious that the time of the making of a transfer is the essential element in determining whether a debt on account of which it is made was antecedent to it.

We conclude that the rule laid down in the second sentence of subdivision a of Section 60 for determining the time of the making of a transfer applies to the determination of the question whether the transfer was made for or on account of an antecedent debt. In this conclusion we are supported by students of the act who have forcefully pointed out that the purpose of Section 60a, as amended by the Chandler Act of 1938, was to strike down secret liens even though given for a present consideration."

As indicated in the Petitioners' brief (page 21), the *Talbot Canning Corporation* case, *supra*, on a second review in the District Court, 39 Fed. Supp. 858, had no bearing on the precise point here involved inasmuch as the District Court found that the transfers complained of were, in fact, made for an antecedent debt. On appeal, however, the

Circuit Court of Appeals for the Fourth Circuit under the name of *Associated Seed Growers, Inc. v. Geib*, 125 Fed. (2d) 683, reversed the District Court; found that the transfers were made for a present consideration and consequently concerned itself with the precise problem here involved. The court held that the validity of the assignment was to be tested by reference to the time when it was made, and if not preferential then, it did not become so because the funds came into the debtor's hands within four months of bankruptcy; predicating its decision upon *Union Trust Company v. Townsend*, 101 Fed. (2d) 903. The court did not concern itself with the history of the legislation nor its object and purpose, at least the reported decision does not so reflect.

In the matter of E. H. Webb Grocery Co., 32 Fed. Supp. 3, 45 Amer. B. R. (New Series) 193 (Petitioners' brief pages 22), the Referee had ruled that the mortgage became effective on the date of its registration as distinguished from the time of its execution; that thus the claim was for an antecedent debt. The District Court held, however, that the amendment to Section 60 simply clarified the former provision and again predicated its conclusion on *Martin v. Commercial National Bank*, *supra*, and that before a trustee may avoid a transfer because of the provisions of Section 60, as amended, he must in fact represent or be entitled to take the place of some creditor whose claim actually stood in a superior position to the challenged transfer, while unrecorded and within the specified period. The court ruled that there had been no substantive change and that the effect, if any, of the statute was simply one of clarification. We submit that this conclusion is erroneous for the reason assigned by Judge Maris in the majority opinion in the case at hand (Record 43).

In *Johnson-Maas Company, Inc., Bankrupt*, 45 Amer. B. R. (New Series) 32, although deciding adversely to the trustee in bankruptcy on the ground that the law of the State of Indiana did not require notice of an assignment or other instrument of transfer to perfect the assignee's title, Referee Wilde, after reciting the provisions of Section 60a and b, said (at page 39):

> "The effect of the above language would seem to be that although an assignment or other instrument of transfer is executed contemporaneously with the making of a loan, if the method or mode of transfer is such that some other creditor could thereafter have acquired any rights in the property transferred by way of security superior to the rights of the original lender, it shall be considered that the transfer was made immediately before bankruptcy, and hence, it must follow, that the transfer was made for or on account of an antecedent debt and would, therefore, be subject to being avoided by the trustee if the person receiving the transfer, at the time the transfer became effective, had reasonable cause to believe that the transferor was insolvent. It would seem, therefore, in the instant case, that the question resolves itself into whether or not a subsequent assignee of the accounts receivable here under consideration could have acquired rights in said accounts, by giving notice to those owing them, superior to the rights of the bank therein. As appears both from the briefs filed on behalf of the trustee in bankruptcy and of the bank, the courts of many states have held that in order to perfect an assignment of accounts, so as to exclude the acquisition of superior rights therein by subsequent assignees, it is necessary to give notice of the assignment to the debtors owing the accounts, the states whose courts have so held including Missouri and Pennsylvania. Such appears also to be the rule in England. In our federal courts

a contrary rule has been adopted. In Salem Trust Company v. Manufacturer's Finance Company, 264 U. S. 182, 68 L. Ed. 628, it was held that mere priority of notice does not give priority of right as between successive assignees of a chose in action. As pointed out, however, by counsel for the trustee in bankruptcy, under the rule followed in Erie Railroad Company v. Tompkins, 304 U. S. 64, — L. Ed. 1188, federal courts look to the law of the state for determination of the substantive law.''

THERE WAS A SECRET LIEN.

Judge Jones of the Circuit Court of Appeals who wrote the minority opinion (Record 50) professed an inability to see how the section was intended to strike down secret liens even though given for a present consideration. The Petitioners argue (their brief, 28) "if the petitioners had given notice to the persons owing the assigned accounts, how would that have made the claims of the petitioners any less secret so far as a subsequent assignee was concerned?". The purpose of the amendment to Section 60 is the protection of creditors and to insure equitable distribution of their debtor's assets in the event of his bankruptcy. The inquiry should properly be "how would the failure of the petitioners to give notice of their assignments have made the claims of the petitioners any less secret so far as creditors were concerned?" It cannot be denied that where notice is given, the fact that the debtor has assigned his accounts receivable permeates business channels and invariably results in putting others dealing with him on notice of their debtor's financial condition. The fact that a debtor does assign his accounts receivable is of great importance in the extension of credit. One of the pertinent factors in the written financial statement in common use today relating to businesses, large and small,

bears on the question whether the subject of credit has assigned his accounts receivable and if so, the extent thereof.

The deficiency heretofore existing in the Bankruptcy Act, the results flowing therefrom and the evil sought by the framers of Section 60 to be corrected are best exemplified by *Zehner v. Southern Surety Co.*, 272 Fed. 954, 47 Amer. B. R. 132, a decision of the Circuit Court of Appeals for the Third Circuit in 1921. Over four months prior to its bankruptcy, a road construction company gave to its surety a bill of sale for its machinery and road building equipment. About two months prior to the bankruptcy of the construction company, the surety took physical possession of the property. The case arose in Pennsylvania and in this State, since *Clow v. Woods*, 5 Sergeant & Rawle (Pa.) 275, decided in 1819, it has been the law that a sale of tangible personal property, leaving the vendor in possession and without doing anything to indicate a change of ownership, is fraudulent as against creditors. The result is that when a vendee or pledgee in Pennsylvania takes title to tangible personal property without taking possession of it, he takes the risk of the integrity and solvency of his vendor or pledgor when the rights of subsequent bona fide purchasers or of levying creditors arise. *White v. Gunn*, 205 Pa. 229. Notwithstanding this state law, to which due recognition was given, the Circuit Court, on the authority of *Bailey v. Baker Ice Machine Co., supra*, was obliged to and did hold that under the 1910 amendment of the Bankruptcy Act, the construction company's trustee in bankruptcy could not recover the machinery from the surety as a preference or otherwise. Thus one who has loaned money, has taken as collateral security therefor a bill of sale for all or a greater part of his debtor's

tangible personal property, may maintain the secrecy of the transaction; permit his debtor to remain in possession with all of the indicia of ownership and to incur obligations upon the strength of such apparent ownership and then, when the bankruptcy of his debtor is imminent, step in and possess himself of the property free of the claims of the trustee and of the creditors; where a creditor, prior to bankruptcy, has not actually levied on the personal property pledged.

STATUS OF A TRUSTEE IN BANKRUPTCY.

In order to affirm the decision of the Circuit Court of Appeals it is unnecessary to constitute a trustee in bankruptcy a bona fide purchaser. The rights of a trustee are measured by what is necessary to perfect a transfer, a test or standard rather than a status and it is not essential to adopt an extreme theory which, if applied elsewhere, would work results not intended. The test is drawn so as to direct judicial investigation of the transfer to a time when it has become notorious or publicly known or has lost the aspect of secrecy such as lack of record or change of possession. As stated succinctly by Jacob I. Weinstein, Esquire, of the Philadelphia Bar, one of the draftsmen of the Chandler Act in *The Bankruptcy Law of 1938* (at page 120) it relates to a point of time "when the debtor has done everything required of him under applicable State law in order to make the transfer so complete that it would be good against the whole world."

It is equally clear that the section does not purport to giving a trustee any right or status not elsewhere conferred. To hold otherwise would make Section 60 ludicrous in application.

Collier on Bankruptcy, supra, page 917.

CONCLUSION.

The affirmance of the decision of the Circuit Court of Appeals here will not, as Petitioners complain, hurt the "little fellow" who must finance through the pledge of his accounts receivable; nor will it cut off one of the greatest available sources of credit; nor will it make any less secure the acceptance of such collateral by banks and finance companies. While in the instance shown by the Petitioners (their brief, 33), the giving of notice might in some instances present practical difficulties, there is no sound legal reason why in those states where the law so requires, compliance cannot be had. The desire to conform cannot be attributed to a reluctance on the part of banks and financial institutions to avoid what may be considered an added burden, but rather on the part of the borrower who desires to keep the knowledge of the assignment secret. Why then does the borrower wish to conceal from his creditors the knowledge that he has pledged his accounts receivable? Obviously, because he knows, as heretofore pointed out, that knowledge that he has assigned his accounts will permeate through the channels of the trade and consequently impair his credit. It is generally known that there are large industries in this country, as for example the textile trade, which to a great extent, are financed by factors to whom the accounts receivable of mills are assigned. In that particular industry it is the practice of the factors not only to notify the customer of the mill of the assignment of the account, but to do the actual billing and the collecting of the account as well.

This complaint made now has no merit in Pennsylvania in view of the adoption of the Act of Assembly of July 31, 1941, Pamphlet Laws 606, Title 69, Purdon's Pennsylvania

Statutes Annotated, Sec. 561, which provides that under the circumstances therein outlined, notice of the transfer or assignment of an account receivable need not be given.

The Petitioners would have us believe that the affirmance of the Circuit Court's holding here would destroy or at least seriously affect the credit structure of the country and point particularly to the bearing of the question upon the financing of war contracts. We lean to the view that a clear cut and complete nullification of all types of secret lien transactions would tend to strengthen rather than weaken the general credit structure and prevent circumstances which encourage the unwise extension of credit. To adopt the language of Judge Knapp of the United States Circuit Court of Appeals for the Fourth Circuit in the case of *Brigman v. Covington*, 219 Fed. 500, 33 Amer. B. R. 644 (at page 648), "we believe this is what the Congress intended and with the more confidence because it tends to enforce that open dealing which is the essential basis of commercial morality."

This position, we urge, is consonant with the intent, aim and purpose of the recent Acts of Congress and Executive Orders which are designed to curtail the unwarranted extension of credit and thus to protect and preserve our national economy.

It is respectfully submitted that the decision of the Circuit Court of Appeals should be affirmed.

Bertram Bennett,
Harry L. Jenkins,
Rawdon Libby,
Counsel for Respondent.

SUPREME COURT OF THE UNITED STATES.

No. 452.—October Term, 1942.

Corn Exchange National Bank and Trust Company, Philadelphia, and Edward C. Dearden, Sr., Petitioners, *vs.* Norman Klauder, Trustee of Quaker City Sheet Metal Co., Bankrupt.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

[March 8, 1943.]

Mr. Justice Jackson delivered the opinion of the Court.

This case requires us to determine the application of the preference provisions of § 60(a) of the Bankruptcy Act as amended by the Chandler Act of June 22, 1938,[1] to loans made on assignments of accounts receivable.

The Quaker City Sheet Metal Company became embarrassed for want of working capital in 1938. Creditors representing a large percentage of claims later proved in bankruptcy agreed to subordinate their claims to those which might be incurred for new working capital. A creditor's committee took supervision of the business and in 1938 arranged with the petitioner Bank to advance from time to time money for payroll and other needs on concurrently made assignments of accounts receivable. At the time of bankruptcy the Company was indebted to the Bank for loans so made on contemporary assignments between January 19, 1940, and April 5, 1940. On April 12, 1940, petitioner Dearden made a loan on similar security. An involuntary petition in bankruptcy was filed against the Company on April 18, 1940, followed by adjudication on May 7, 1940. When the assignments were made they were recorded on the Company's books, but neither petitioner had ever given notice of assignment to the debtors whose obligations had been taken as security. Because of this omission

1 52 Stat. 840, 869-870; 11 U. S. C. § 96(a).

the trustee challenged their right to the benefits of their security. He was overruled by the referee and the District Court, but his position was sustained by the Circuit Court of Appeals for the Third Circuit,[2] on an interpretation of § 60(a) which conflicts with an interpretation by the Circuit Court of Appeals for the Fifth Circuit.[3] Hence we granted certiorari.[4]

Section 60(a) as amended and applicable reads:

"A preference is a transfer, as defined in this Act, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition in bankruptcy, . . . the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class. For the purposes of subdivisions a and b of this section, a transfer shall be deemed to have been made at the time when it became so far perfected that no bona-fide purchaser from the debtor and no creditor could thereafter have acquired any rights in the property so transferred superior to the rights of the transferee therein, and, if such transfer is not so perfected prior to the filing of the petition in bankruptcy . . . it shall be deemed to have been made immediately before bankruptcy."

Section 1(30) specifically provides that "transfer" includes an assignment.[5]

The Circuit Court of Appeals has determined, and we accept its conclusion, that at all relevant times it was the law of Pennsylvania, where these transactions took place, that because of the failure of these assignees to give notice to the debtors whose obligations were taken, a subsequent good-faith assignee, giving such notice, would acquire a right superior to theirs.[6] It held that the assignments were preferences under § 60(a) and therefore, under the terms of § 60(b),[7] inoperative against the trustee.

This is undoubtedly the effect of a literal reading of the Act. Its apparent command is to test the effectiveness of a transfer, as against the trustee, by the standards which applicable state

[2] 129 F. 2d 894.

[3] Adams v. City Bank & Trust Co., 115 F. 2d 453.

[4] — U. S. —.

[5] 52 Stat. 840, 842, 11 U. S. C. § 1(30).

[6] Phillips's Estate (No. 3), 205 Pa. 515; cf. Phillips's Estate (No. 4) 205 Pa. 525. Pennsylvania has since provided by statute that notice of the assignment on the assignor's books will protect the assignee. Pa. Laws, 1941, No. 255, p. 606 (July 31, 1941), 69 Purd. Stat. Ann. § 561.

[7] 52 Stat. 840, 870, 11 U. S. C. § 96(b).

law[8] would enforce against a good-faith purchaser. Only when such a purchaser is precluded from obtaining superior rights is the trustee so precluded. So long as the transaction is left open to possible intervening rights to such a purchaser, it is vulnerable to the intervening bankruptcy. By thus postponing the effective time of the transfer, the debt, which is effective when actually made, will be made antecedent to the delayed effective date of the transfer and therefore will be made a preferential transfer in law, although in fact made concurrently with the advance of money. In this case the transfers, good between the parties, had never been perfected as against good-faith purchasers by notice to the debtors as the law required, and so the conclusion follows from this reading of the Act that the petitioners lose their security under the preference prohibition of § 60(b).

Such a construction is capable of harsh results,[9] and it is said that it will seriously hamper the business of "non-notification financing," of which the present case is an instance. This business is of large magnitude and it is said to be of particular benefit to small and struggling borrowers.[10] Such consequences may, as petitioners argue, be serious, but we find nothing in Congressional policy which warrants taking this case out of the letter of the Act.

The Committee of the House of Representatives which reported § 60(a) as quoted above was fully aware of the vicissi-

[8] Questions of this sort arising in bankruptcy cases were solved by reference to state law even before the decision of Erie Railroad Co. v. Tompkins, 304 U. S. 64. Holt v. Crucible Steel Co., 224 U. S. 262; Benedict v. Ratner, 268 U. S. 353. The decision in Salem Trust Co. v. Manufacturers' Finance Co., 264 U. S. 182, that, as a matter of "general law," absence of notice to the debtor of the assignment of his account did not open the door to a subsequent assignee to obtain superior rights, was not rendered in a bankruptcy case, and is in any event inapplicable since the decision of the Tompkins case.

[9] Whether the petitioners have any rights under the agreement of some of the creditors to subordinate their claims to those which might be incurred for new working capital is a question which has neither been raised by the parties nor considered by the Court.

[10] Petitioners cite and rely upon Saulnier and Jacoby, Accounts Receivable Financing (National Bureau of Economic Research, 1943), for an estimate that in 1941 commercial finance companies advanced $536,000,000 on this basis; and commercial banks, $952,000,000. Of the borrowers, it was estimated that 63% had total (not net) assets of less than $200,000; and 31%, less than $50,000. Their borrowing was estimated, however, to amount to less than 19% of the total. *Id.* at 17, 32, 64.

"Factoring," a system involving notice to the trade debtors, and confined principally to the textile industry, amounted in 1941 to $1,150,000,000. *Id.* at 3, 17, 58 *et seq.*

tudes of its predecessors.[11] These are recited in detail elsewhere, and need not be repeated here beyond a general statement that for thirty-five years Congress has consistently reached out to strike down secret transfers, and the courts have with equal consistency found its efforts faulty or insufficient to that end.[12] Against such a background § 60(a) was drawn and reported to Congress with this explanation of its purpose and effect: "The new test is more comprehensive and accords with the contemplated purpose of striking down secret liens. It is provided that the transfer shall be deemed to have been made when it has become so far perfected that neither a bona-fide purchaser nor creditor could thereafter have acquired rights superior to those of the transferee. As thus drafted, it includes a failure to record and any other ground which could be asserted by a bona-fide purchaser or a creditor of the transferor, as against the transferee. A provision also has been added which makes the test effective even though the transfer may never have actually become perfected."[13]

Whatever advantages may inhere in non-notification financing which might have made Congress reluctant to jeopardize it, the system also has characteristics which make it impossible for us to conclude that it is to be distinguished from the secret liens Congress was admittedly trying to reach.

---

11 See statement of Professor McLaughlin, Hearings, Revision of the Bankruptcy Act, House Judiciary Committee, 75th Cong., 1st Sess., pp. 122-125. He stated Thompson *v.* Fairbanks, 196 U. S. 516, as applying a rule of state law that a mortgagee by taking possession of the mortgaged property at a time subsequent to the execution of the mortgage thereby validated it as of the time of execution. He said that § 60(a) would prevent such validation by relation back. Similar disapproving reference was made to Bailey *v.* Baker Ice Machine Co., 239 U. S. 268; Carey *v.* Donohue, 240 U. S. 430; and Martin *v.* Commercial National Bank, 245 U. S. 513; with the explanation that "You are going to have taken away some advantages that some people have enjoyed, and certain practices are going to be altered to some extent. But you have that every time you pass any kind of a commercial law."

12 See cases cited in the note above; Hirschfeld *v.* Nogle, 5 Fed. Supp. 234; 3 Collier on Bankruptcy (14th Ed.) §§ 60.05, 60.37. The history and meaning of the present § 60(a) are discussed in 3 Collier, *op. cit. supra*, § 60.48; 2 Glenn, Fraudulent Conveyances and Preferences (1940) § 534; Hanna, Some Unsolved Problems under Section 60A of the Bankruptcy Act, 43 Columbia Law Review 58; McLaughlin, Aspects of the Chandler Bill to Amend the Bankruptcy Act, 4 University of Chicago Law Review 369; Neuhoff, Assignment of Accounts Receivable as Affected by the Chandler Act, 34 Illinois Law Review 538; Mulder, Ambiguities in the Chandler Act, 89 University of Pennsylvania Law Review 10; Hamilton, The Effect of Section Sixty of the Bankruptcy Act upon Assignments of Accounts Receivable, 26 Virginia Law Review 168.

13 H. R. Rep. No. 1409, 75th Cong., 1st Sess., p. 30.

Receivables often are assigned only when credit in a similar amount is not available through other channels.[14] Interest and other charges are high,[15] and an assignment often is correctly understood as a symptom of financial distress.[16] The borrower does not wish his customers to learn of his borrowing arrangement for the reason, among others, that customers, particularly in placing orders for future delivery, prefer to rely on solvent suppliers. And often the borrower desires to conceal the fact that he is being financed by this method lest knowledge lead to a withdrawal of further credit or refusal of new credit.[17] The borrower and the lender on assigned accounts receivable thus have a mutual interest in not making the transaction known. So long as the transaction may remain a secret, it is not apt to become known to the trade. When the transaction is communicated to the trade debtors it is known where there is less motive to keep it under cover. Commercial and trade reporting agencies are diligent to obtain credit information of this character. Its dissemination may often have adverse effects upon both the borrower and the lender, but they are not the only interested parties. Secrecy has the effect of inducing others to go along with the borrower in ignorance where they would not do so if informed.

It is said that assignments such as are involved in this case could not have been within the contemplation of the Act since its application will have but little effect in remedying whatever secrecy

---

14 Saulnier and Jacoby, *op. cit. supra*, note 10, pp. 6, 21 *et seq.*, 61 *et seq.*

15 Effective rates are estimated to range from approximately 9% per annum on money in use for the best borrowers to 20% per annum for those whose accounts present the financing company with the heaviest operating costs and whose receivables are of a quality to command only a relatively low percentage advance. *Id.* at 86, 131 *et seq.*

16 *Id.* at 22, 99.

17 "Another reason for the use of the non-notification procedure, although less important than other motives and less relevant at present than formerly, seems to have been the desire on the part of the concern being financed to keep the fact of its use of this source of funds from becoming known to its creditors. Presumably these creditors would be less likely to grant the concern further credit on the ground that resort to accounts receivable financing reflected an unsatisfactory financial position and impaired their own security. It seems likely that this attitude toward non-notification financing may be traced to a mixture of simple prejudice and genuine experience with cases where creditors' meetings disclosed for the first time that the bankrupt had secretly assigned his most liquid assets and made unproductive use of the funds so acquired. Genuine experience must have been the more important basis of the two for it its unlikely that an attitude and prejudice so deeply embedded could be founded entirely on misinformation and irrational judgment." *Id.* at 22.

attends them. It is true that notice to the debtors sufficient to satisfy the requirements of applicable state law might never have been communicated to the creditors, and that many states do not require notice to the debtor to foreclose possible superior rights of subsequent assignees.[18] So also is it true that conflicts and confusion may result where the transaction or location of the parties is of such a nature that doubt arises as to which of different state laws is applicable. But the fact that the remedy may fall short in these respects does not justify denying it all effect.

That the assignments in this case were made with the knowledge and acquiescence of many creditors does not cure the failure to meet the requirements of notice laid down by the applicable state law. Neither the words nor the policy of § 60 (a) afford any warrant for creating exceptions to fit isolated hard cases.

The judgment below is

Affirmed.

Mr. Justice RUTLEDGE did not participate in the consideration or decision of this case.

Mr. Justice ROBERTS is of opinion that the judgment should be reversed for reasons stated in the dissenting opinion below, 129 F. 2d 897, and in *Adams* v. *City Bank & Trust Co.*, 115 F. 2d 453; *Girand* v. *Kimbell Milling Co.*, 116 F. 2d 999, *In re Talbot Canning Corp.*, 35 F. Supp. 680; *Associated Seed Growers, Inc.* v. *Geib*, 125 F. 2d 683, and *In re E. H. Webb Grocery Co.*, 32 F. Supp. 3.

A true copy.

Test:

Clerk, Supreme Court, U. S.

---

[18] See 2 Williston, Contracts (Rev. Ed.) § 435, and Hamilton, *loc. cit supra*, note 12